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Financial Collateral Arrangements : Directive 2002/47/EC and the Many Faces of Reasonableness

Michele Graziadei *

I. – INTRODUCTION

The world of financial guarantees is primarily governed by the standard terms of the Master agreement governing all the transactions entered into by the parties to the agreement.¹ How that agreement works under the applicable law(s) governing the various aspects of the transaction is one of the problems that the parties must consider if they wish to avoid the risks associated with an uncertain legal regime.²

This article looks at the discrepancies among the various linguistic versions of Article 4, Section 6 of *Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements*³ concerning the requirement of commercial reasonableness in the realisation or valuation of financial collateral, and shows that such discrepancies should not be a matter of concern in the interpretation and application of the Directive.

II. – REASONABLENESS IN DIRECTIVE 2002/47/EC OF 6 JUNE 2002 ON FINANCIAL COLLATERAL ARRANGEMENTS

The Directive on financial collateral arrangements has reduced the level of legal uncertainty associated with financial collateral arrangements by ensuring that the laws of the Member States all accept that:

“(...) on the occurrence of an enforcement event, the collateral taker shall be able to realise (...) any financial collateral provided under, and subject to the terms agreed in, a security financial collateral arrangement (...)” (Directive on financial collateral arrangements, Article 4.1)

To this purpose, the Directive ensures that, under the laws of the Member States, the terms agreed in the security financial collateral arrangement as to the manner of realising the collateral do not introduce requirements that delay the realisation of the security, such as prior notice of the intention to realise the security, approval of that intention by any court, public officer, or other person, sale of the security by public auction, and so on (Directive on financial

* Full Professor of Law, University of Turin (Italy).

¹ In most cases, this will be the master agreement made available by the International Swaps and Derivatives Association (ISDA). For a rich study illuminating the global as well as the local aspects of trading under such agreements, see A. RILES, *Collateral Knowledge: Legal Reasoning in the Global Financial Markets*, Chicago (2011); for general commentary on the Directive: T.R.M.P. KEIJSER, *Financial collateral arrangements: the European Collateral Directive considered from a property and insolvency law perspective*, Deventer (2006).

² A. GARDELLA, *Le garanzie finanziarie nel diritto internazionale privato*, Milano (2007).

³ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, in: *Official Journal* L 168, 27.6.2002, (p.) 43 (hereinafter: “Directive on financial collateral arrangements” or “the Directive”).

collateral arrangements, Article 4.4). However, the same text also provides that the Directive should not prejudice:

"(...) any requirements under national law to the effect that the realisation or valuation of financial collateral and the calculation of the relevant financial obligations *must be conducted in a commercially reasonable manner.*" (Directive on financial collateral arrangements, Article 4(6), emphasis added)

This provision applies both to the rule sanctioned by Article 4 of the Directive, according to which the security is to be realised in accordance with the terms of the security collateral arrangement, and to the rules contained in Articles 5, 6, 7 of the same Directive. These Articles deal respectively with the right of use of financial collateral under security financial collateral arrangements, the recognition of title transfer financial collateral arrangements, and the recognition of close-out netting provisions. The recitals of the Directive make clear the purpose of this instrument:

"This Directive provides for rapid and non-formalistic enforcement procedures in order to safeguard financial stability and limit contagion effects in case of a default of a party to a financial collateral arrangement. However, this Directive balances the latter objectives with the protection of the collateral provider and third parties by explicitly confirming the possibility for Member States to keep or introduce in their national legislation an *a posteriori* control which the Courts can exercise in relation to the realisation or valuation of financial collateral and the calculation of the relevant financial obligations. Such control should allow for the judicial authorities to verify that the realisation or valuation has been conducted in a commercially reasonable manner." (Directive on financial collateral arrangements, Recital No. 17)

Readers who are familiar with the provisions of the Uniform Commercial Code (UCC) in force in the various states of the United States will not fail to recognise that the reasonableness requirement in Article 4(6) of the Directive has its precedent in Sections 9-610(b) and 9-627 of the UCC: both sections require that the realisation of collateral given as security must take place "in a commercially reasonable manner".⁴ However, while the UCC is a monolingual uniform legislative text, the Directive, just like other legislation enacted by the European Union, is multilingual. In other words, the English text of the Directive refers to reasonableness, but that text of the Directive is just one of the twenty-three texts in which that instrument is enacted.

This raises the question of how that reference to reasonableness has been spelled out in the twenty-two other languages in which the Directive is written. Furthermore, each Directive must be transposed into the Member States' national legal systems. Hence, one can also raise a further question: how was that reference translated into the national legislation transposing the Directive into the laws of the Member States? Theoretical approaches to reasonableness sometimes hint at similar problems without, however, fully engaging with them.⁵

Due to the limited linguistic skills of the author of this article, no attempt will be made to provide a complete answer to these questions for all the twenty-three official languages of the European Union. Nonetheless, even a summary examination of the issue reveals some discrepancies both among the various texts of the Directive, and among the national texts implementing it. This may be cause for concern, in the light of the obligation to interpret

⁴ F. MURINO, *L'autotutela nell'escussione della garanzia finanziaria pignorizia*, Milano (2010), 83 ff., for commentary on this standard, and its relationship to good faith.

⁵ See, e.g., G. Bongiovanni / G. Sartor / C. Valentini (Eds.), *Reasonableness and Law*, Dordrecht/Heidelberg/London/New York (2009).

national legislation in conformity with EU law.⁶ As will be seen, however, this concern is unjustified in the case at hand. For reasons that will be explained in the final part of this paper, this is a case in which the different texts enacted in the various languages – both at the European and the national level – do not raise concerns as to their meaning that might lead to a preliminary ruling of the European Court of Justice as to their interpretation, under Article 267 of the Treaty on the Functioning of the European Union (TFEU).

III. – THE FRENCH, ITALIAN, PORTUGUESE, GERMAN, AND DUTCH TEXTS OF THE DIRECTIVE

So how do the other texts of the Directive express the concept that in its English version is worded as we have just seen above?

Let us begin answering this question by considering the French text of the relevant part of Article 4 of the Directive, which may not prejudice:

"(...) une obligation imposée par le droit national de procéder à la réalisation ou à l'évaluation des instruments financiers donnés en garantie et au calcul des obligations financières couvertes dans des conditions commerciales normales." (Directive on financial collateral arrangements, Article 4(6), emphasis added).

The English wording making reference to the obligation to conduct certain operations "in a commercially reasonable manner" in the French text becomes the obligation to conduct these same operations "*dans des conditions commerciales normales*". Those who penned the French text of the Directive therefore avoided any reference to the notion of reasonableness, and tried to operationalise the same concept by making reference to a normal state of affairs from the commercial point of view. Why did they opt for this alternative version?

Let us pause to note that, in other contexts, the English and French expressions under consideration do not present this variation. The Luxembourg *Protocol on Matters specific to Railway Rolling Stock* (Luxembourg, 2007) to the Cape Town *Convention on International Interests in Mobile Equipment*, drafted in a single original in the English, French and German languages, under the auspices of the International Institute for the Unification of Private Law (UNIDROIT), contains the expression "in a commercially reasonable manner" (Article VII(3)). In that context, the French text matches the English text without further ado. The parallel wording is: "*d'une manière commercialement raisonnable*" (Article VII(3)). The drafters of the various versions of the same instrument by and large followed the same approach when that instrument was given effect in Europe by the Council Decision of 30 November 2009 (2009/940/EC).⁷

A first possibility is that the two texts of the Directive (the English and the French versions) were produced independently, so that the variation mentioned above reflects a lack of coordination among them. This is an unlikely bet, in light of the other language versions in which the Directive was drafted,⁸ and because of the structure of the process giving form to

⁶ See B. Pozzo / A. Jacometti (Eds.), *Multilingualism and the Harmonisation of European Law*, Deventer (2006); G. DANNEMANN / S. FERRERI / M. GRAZIADEI, "Language and Terminology", in: C. Twigg-Flesner, *The Cambridge Companion to European Union Private Law*, Cambridge (2010), 70 ff.; For a fascinating view of what goes on in practice, see M. DERLÉN, *Multilingual Interpretation of European Community Law*, The Hague (2009).

⁷ *Official Journal* L 331/1, 16.12.2009. The German version of this instrument speaks of "*in wirtschaftlich angemessener Weise*".

⁸ They are considered *infra*, in this part of the article.

European legislation, which requires respect of the multilingual nature of European legislation.⁹ Another possibility is that the authors of the Directive wished to avoid what might have been considered an Anglicism that should have been avoided in a European text.¹⁰ It is well-known that the notion of reasonableness refers to a standard commonly associated with the law of common law jurisdictions.¹¹ Although references to reasonableness are becoming more frequent in the legislation of civilian jurisdictions, and are certainly well represented in European texts such as the proposal for a common European sales law,¹² it is true that purists in some countries may still object to its use, and express a preference for a terminology which could be considered more neutral in this respect.¹³

If this concern inspired the choice of words made by the drafters of the French version of the Directive, it most decidedly did not guide the hand of the drafters of the Italian and Portuguese texts of the Directive, since these do make reference to the notion of reasonableness.

Thus the relevant part of the Italian text of the Directive:

"Il presente articolo e gli articoli 5, 6 e 7 non pregiudicano gli obblighi, stabiliti in virtù delle leggi nazionali, che il realizzo o la valutazione della garanzia finanziaria e il calcolo delle obbligazioni finanziarie garantite abbiano luogo in condizioni ragionevoli sotto il profilo commerciale." (Directive on financial collateral arrangements, Article 4(6), emphasis added)

The Portuguese text also adopts the notion of reasonableness:

"O disposto no presente artigo e nos artigos 5.o, 6.o e 7.o não prejudica qualquer obrigação, imposta nos termos da legislação nacional, de proceder à realização ou avaliação da garantia financeira e ao cálculo das obrigações financeiras cobertas segundo critérios comerciais razoáveis." (Directive on financial collateral arrangements, Article 4(6), emphasis added)

Yet it would be wrong to think that the French text of the Directive is the only version of that text that does not make reference to the notion of reasonableness. The Spanish text of the Directive also avoids referring to it:

"El presente artículo, así como los artículos 5, 6 y 7, se aplicarán sin perjuicio de los requisitos impuestos por la legislación nacional para que la ejecución o valoración de la

⁹ See on this point the Interinstitutional Agreement of 22 December 1998 (*Official Journal* C 73, 17.3.1999, (pp.) 1–4), on common guidelines for the quality of drafting of Community legislation, point 5: "Throughout the process leading to their adoption, draft acts shall be framed in terms and sentence structures which respect the multilingual nature of Community legislation; concepts or terminology specific to any one national legal system are to be used with care."

¹⁰ See point 5 of the Interinstitutional Agreement mentioned *supra*, note 9.

¹¹ See, e.g., G. FLETCHER, "Fair and Reasonable: A Linguistic Glimpse into the American Legal Mind", in: R. Sacco / L. Castellani (Eds.), *Les multiples langues du droit européen uniforme*, Torino (1999), 57 ff.

¹² Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law, COM (2011) 635, Art. 5, in: *Official Journal* C 2012/37, (p.) 16.

¹³ D. MANGUY, "Le 'raisonnable' en droit (des affaires)" in: E. Le Dolley (Ed.), *Les concepts émergents en droit des affaires*, Paris (2010), notes that the French Code civil contains only one reference to this notion in its Art. 1112 (on duress as a cause of invalidity of contracts). The author concludes that "(...)le concept de 'raisonnable' est, en tant que tel, inconnu ou presque de la tradition de droit français des contrats (...)" ((p.) 316). The point is further pursued by H. RAMPARANY-RAVOLOLOMIARANA, *Le raisonnable en droit des contrats*, thèse, Poitiers (2009). For a reflection from a European perspective, see B. FAUVARQUE-COSSON / D. MAZEAUD, *European Contract Law: Materials for a Common Frame of Reference: Terminology, Guiding principles, Model Rules*, Munich (2008), 150 ff., and *passim*.

garantía financiera y el cálculo de las obligaciones financieras principales se lleven a cabo de una manera comercialmente correcta." (Directive on financial collateral arrangements, Article 4(6), emphasis added)

Here, the text implies that the European text does not prejudice the requirement imposed under the national law that the relevant operations must be carried out in a way corresponding to the notion of fair dealing ("*de una manera comercialmente correcta*").

Turning to the German and Dutch texts of the Directive, we come across further differences. The German text requires that the relevant operation be carried out "*nach wirtschaftlichen Gesichtspunkten*", while the Dutch text of the Directive makes reference to the notion of reasonableness, just like the Italian and the Portuguese versions. This is hardly surprising, in light of the fact that the Dutch Civil Code is one of the Civil Codes that makes use of the notion of reason and reasonableness as general standards:¹⁴

Article 3:12 "In determining what reasonableness (*redelijkheid*) and equity (*billijkheid*) require, generally accepted principles of law, current juridical views in the Netherlands and the societal and private interests involved in the case must be taken into account."

Article 6:2 "An obligee and obligor must, as between themselves, act in accordance with the requirement of reasonableness and equity. The rule to which their relationship is subject by virtue of the law, custom or a juridical act does not apply if, in the circumstances, this would be unacceptable according to standards of reasonableness and equity."

If we look at the implementing legislation at the national level, the wording is just as varied as that which prevails at the European level. The relevant French text makes reference to normal market conditions:

"La réalisation de telles garanties intervient à des conditions normales de marché, par compensation, appropriation ou vente, sans mise en demeure préalable, selon les modalités d'évaluation prévues par les parties dès lors que les obligations financières couvertes sont devenues exigibles." (Code monétaire et financier, Article L211-38, emphasis added)

The Spanish text follows the Spanish version of the Directive, and speaks of a fair way of proceeding in the valuation or realisation of the security, which must take place "*de una manera comercialmente correcta*".¹⁵

If we look to the national legislation implementing the Directive in those legal systems that encapsulate multiple legal traditions, we find indicia of attempts to bring together various types of check upon the evaluation and realisation of the security. Thus, Maltese law requires that the realisation of the security be conducted not only in a commercially reasonable way, but also in "good faith, to ensure "fair treatment" to the collateral provider:

¹⁴ See also Art. 6:248 on reasonableness and equity in the determination of contractual effects. The translations in the text are based on *The New Netherlands Civil Code – Patrimonial Law* (trilingual edition English/French/Dutch), translated by P.P.C. Haanappel and E. Mackaay, Deventer and Boston, MA (1990); see also H. WARENDORF / R. THOMAS / I. CURRY-SUMNER, *The Civil Code of the Netherlands*, Alphen a/d Rijn (2009). Dutch interpreters point out that this reference to reasonableness was inserted in the Code to avoid any confusion between the objective and the subjective notion of good faith. See D. DANKERS-HAGENAARS, "Rapport Néerlandais", in: *La bonne foi (journées louisianaises)*, Travaux Association Capitant, tome XLIII, Paris (1992), 311; also M.E. STORME, "Rapport Néerlandais", *ibid.*, 163.

¹⁵ *Real Decreto-ley 5/2005, de 11 de marzo, de reformas urgentes para el impulso a la productividad y para la mejora de la contratación pública*, Art. 13.

"(...) the collateral taker shall ensure that any action taken in terms of these regulations, including any realisation or valuation of the financial collateral, be conducted in accordance with the terms of the financial collateral arrangement and in any event *in a commercially reasonable manner and in good faith* so as to ensure *fair treatment* to the collateral provider." (Financial Collateral Arrangements Regulations 2004, emphasis added).

IV. – MUCH ADO ABOUT NOTHING?

It appears from the above survey that the various language versions of the Directive do not match and to some degree imply different concepts, as do the texts that implement the Directive at the national level. In particular, the national legislation implementing the Directive in France makes reference to normal market conditions, whereas other texts do not contain any reference to such conditions. Readers will also be able to detect a number of other noticeable variations that have slipped into the various texts in which the Directive is in force, which I will not examine here. But, having noted all these variations, do we need to worry about them? In particular, will these variations raise questions of interpretation to be solved sooner or later by the European Court of Justice under the preliminary ruling procedure of Article 267 TFEU?

The short answer to these questions is a plain "no". No matter how different the texts of the Directive on the point of what "reasonableness" is to be, reference to the concept in this context will not raise any question for the European Court of Justice to answer on the basis of Article 267 TFEU.

VI. – CONCLUSION

In reaching this conclusion, it should be borne in mind that the Directive leaves to the laws of the Member States the possibility to keep or introduce in their national legislation an *a posteriori* control that the courts can exercise in relation to the realisation or valuation of financial collateral, and to the calculation of the relevant financial obligations. It is only at this stage that the Member States' judicial authorities may be authorised under the national legislation to verify that the operations in question have been conducted in a commercially reasonable manner. Therefore, the reasonableness requirement contemplated by the Directive, if it is imposed at all, will be imposed under the national legislations of the Member States, not by the European lawmakers. This explains why the drafters of the Directive did not have to address the question of how to render the notion of reasonableness uniform across the different texts of the Directive. By the same token, it is impossible to maintain that such uniformity should be established by the European Court of Justice, as the Court is not competent in this matter.

A last point to make is that, by allowing national legislation to establish an *ex post* check based on "commercial reasonableness" over the realisation or valuation of financial collateral and the calculation of the relevant financial obligations, the Directive is not leaving the door open to legislation adopting a standard that is by itself at odds with the obligations of the parties under the agreement. Indeed, the widely used ISDA Master Agreement 2002 does impose obligations of reasonableness and good faith, *e.g.*, in the determination of the "close-out amount" due as a consequence of the termination of the contract, in accordance with the

definition of that term provided in the Master Agreement.¹⁶ Sometimes, the national legislation implementing the Directive takes this point into account, *e.g.*, by making it clear that “commercial reasonableness” will be presumed whenever the contractual terms agreed between the parties correspond to the content of the parties’ obligations under financial guarantees that are agreed upon on terms that are commonly recognised in international trade.¹⁷

In Europe, therefore, reasonableness remains a concept with many faces, even in an area of the law that, more than others, requires certainty and stability.¹⁸ Under these conditions, harmonisation of the law can only derive from a comparative exercise, and from voluntary attempts to establish a common meaning of the concept.

¹⁶ The 2002 ISDA Master Agreement, for example, provides that the non-defaulting party in determining the close-out amount must “act in good faith and use commercially reasonable procedures in order to produce a commercially reasonable result.” For commentary on the point, see R. GROVE, “Valuation in the Context of Derivatives Litigation”, 6 *Capital Markets Law Journal* (2011), 149; MURINO, *supra* note 4, 97 ff.

¹⁷ D. Lgt 21 maggio 2004, n. 170, Attuazione della direttiva 2002/47/CE, in materia di contratti di garanzia finanziaria, Art. 8.(Condizioni di realizzo e criteri di valutazione):

“1. Le condizioni di realizzo delle attività finanziarie ed i criteri di valutazione delle stesse e delle obbligazioni finanziarie garantite devono essere ragionevoli sotto il profilo commerciale. Detta ragionevolezza si presume nel caso in cui le clausole contrattuali concernenti le condizioni di realizzo, nonché i criteri di valutazione, siano conformi agli schemi contrattuali individuati dalla Banca d’Italia, d’intesa con la CONSOB, in relazione alle clausole di garanzia elaborate nell’ambito della prassi internazionale.”

¹⁸ This is also true of the concept of good faith under the case law of the European Court of Justice on unfair contract terms: Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co KG v. Hofstetter* [2004] ECR I-3403, paras. 19-22, and intervening case law.